

The current power purchase agreement between DMG and Illinois Power requires that notice of termination be presented by December 31, 2003, one year prior to the scheduled expiration. The parties have agreed to amend the agreement to extend this notice date requirement to March 31, 2004.

In the event that both the pending transaction for the sale of Illinois Power to Ameren is not completed, the existing agreement with DMG is terminated and no replacement agreement is executed with a Dynegy affiliate, Illinois Power will be required to purchase a substantial portion of its power on the open market at then current market prices. In the event that the Ameren transaction is not completed and the existing agreement with DMG is either not terminated or is replaced by another agreement with a Dynegy affiliate, Illinois Power will be required to purchase any amount of capacity and energy not provided under the contract on the open market at then current market prices. Volatility in market prices for power could affect Illinois Power to the extent that it would be required to purchase power in the open market.

CRM Outlook. Our CRM business' future results of operations will be significantly impacted by our ability to execute our exit strategy. We continue to explore opportunities to assign or renegotiate the terms of some of our four remaining power tolling arrangements. If we do not renegotiate or terminate these power tolling arrangements, these arrangements will continue to negatively impact our earnings and cash flows based on the current pricing environment. Even if we do renegotiate or terminate some of these arrangements, we could be required to pay a significant amount of cash relating to any such renegotiation or termination which may also negatively impact earnings and cash flows. For a discussion of our annual and long-term obligations under these arrangements, see Item 1. Business—Segment Discussion—Customer Risk Management beginning on page 18.

The earnings of the CRM segment may also be significantly impacted, either positively or negatively, by mark-to-market changes in the value of a derivative contract associated with the Sithe Independence tolling agreement as power and gas prices change.

We have posted approximately \$120 million of collateral associated with this business. Approximately \$20 million of this balance relates to our tolling arrangements. An additional \$40 million relates to the ABG Gas Supply gas contract, which will expire in the first quarter of 2006. The remaining \$60 million is related to our legacy gas and power positions, which collateral will be substantially eliminated by 2007.

CASH FLOW DISCLOSURES

The following tables include data from the operating section of the consolidated statements of cash flows and include cash flows from our discontinued operations, which are disclosed on a net basis in loss on discontinued operations, net of tax, in the consolidated statements of operations:

For the Year Ended December 31, 2003						
	GEN	NGL	REG	CRM	Other & Eliminations	Consolidated
	(in millions)					
Operating Cash Flows Before Changes in Working Capital						
Capital	\$457	\$233	\$ 198	\$(29)	\$(420)	\$439
Changes in Working Capital	(29)	(47)	(131)	525	119	437
Net Cash Provided by (Used in) Operating Activities	<u>\$428</u>	<u>\$186</u>	<u>\$ 67</u>	<u>\$496</u>	<u>\$(301)</u>	<u>\$876</u>
For the Year Ended December 31, 2002						
	GEN	NGL	REG	CRM	Other & Eliminations	Consolidated
	(in millions)					
Operating Cash Flows Before Changes in Working Capital						
Capital	\$349	\$ 73	\$ 371	\$ 200	\$(124)	\$ 869
Changes in Working Capital	(91)	(49)	(109)	(518)	(127)	(894)
Net Cash Provided by (Used in) Operating Activities	<u>\$258</u>	<u>\$ 24</u>	<u>\$ 262</u>	<u>\$(318)</u>	<u>\$(251)</u>	<u>\$ (25)</u>
For the Year Ended December 31, 2001						
	GEN	NGL	REG	CRM	Other & Eliminations	Consolidated
	(in millions)					
Operating Cash Flows Before Changes in Working Capital						
Capital	\$431	\$147	\$ 269	\$ 180	\$43	\$1,070
Changes in Working Capital	71	12	(160)	(476)	33	(520)
Net Cash Provided by (Used in) Operating Activities	<u>\$502</u>	<u>\$159</u>	<u>\$ 109</u>	<u>\$(296)</u>	<u>\$76</u>	<u>\$ 550</u>

Operating Cash Flow. Our cash flow provided by operations totaled \$876 million for the 12 months ended December 31, 2003. Cash provided in 2003 primarily relates to collateral returns, settlements of risk management assets and sales of natural gas storage in excess of \$500 million from our CRM business, a \$110 million income tax refund and solid operational performances from our GEN, NGL and REG segments. Despite a relatively weak commodity price environment, our GEN segment provided cash flows in excess of \$400 million largely due to effective commercial and operational management and our coal- and dual-fired generation assets. Similarly, our NGL segment contributed cash flows from operations in excess of \$180 million due to a strong commodity price environment, particularly in the upstream business, offset by increases in prepayments and lower downstream results due to industry-wide reductions in volumes available for fractionation. Our REG segment contributed operating cash flows in excess of \$60 million, primarily from normal operating conditions, offset by working capital outflows due to increased injection of gas into storage, as well as an increase in prepayments. General and administrative costs, a \$45 million litigation settlement and continued extinguishment of liabilities during our exit from our communications business offset these positive operational cash flows during the 12 months ended December 31, 2003.

For the 12 months ended December 31, 2002, our cash flow used in operations was \$25 million. When compared to 2003, the primary driver of our operating cash outflows was our required posting during 2002 of significant amounts of collateral under the terms of our CRM commercial contracts due to the degradation of our credit ratings.

For the 12 months ended December 31, 2001, our cash flow provided by operations totaled \$550 million. Our GEN segment experienced strong operational results, reflecting added generation capacity and a favorable commodity price environment, which contributed operating cash flows of approximately \$500 million. Similarly, our NGL segment experienced strong operational results stemming from beneficial price realization and positive working capital changes related to sales of natural gas liquids in storage due to the favorable business environment.

Capital Expenditures and Investing Activities. Cash used in investing activities for the 12 months ended December 31, 2003 totaled \$266 million. Our capital spending totaled \$333 million and was primarily comprised of routine capital maintenance of our existing asset base. Of this amount, we spent approximately \$40 million on the construction of Rolling Hills, which began commercial operations in June 2003. Our proceeds from asset sales totaled approximately \$72 million and primarily relate to our sale of Hackberry LNG Terminal LLC (\$35 million), SouthStar (\$20 million), and generation equity investments (\$25 million), which were offset by \$10 million in cash outflows associated with the sale of our European communications business.

During the 12 months ended December 31, 2002, cash provided by investing activities totaled \$677 million. Our capital spending totaled \$947 million and was primarily comprised of improvements to the existing asset base. Of this amount, we spent approximately \$195 million on the construction of Rolling Hills. Additionally, we spent \$83 million on our discontinued communications business and incurred \$54 million in capital expenditures associated with information technology. Business acquisitions of \$20 million relate to our acquisition of Northern Natural, net of cash acquired. We received \$1.5 billion in proceeds from asset sales primarily from the sales of Northern Natural in August 2002 (\$879 million), the Hornsea gas storage facility in September 2002 (\$189 million) and the Rough gas storage facility in November 2002 (\$500 million). Other investing activities include proceeds from the sale of Northern Natural bonds.

Finally, cash used in investing activities in 2001 totaled \$3.8 billion. Included in 2001 capital expenditures is the purchase of the Central Hudson power generation facilities for \$903 million. Additional capital expenditures of approximately \$1.7 billion principally related to the construction of power generation assets, improvements of existing facilities related to the REG segment and investments associated with technology infrastructure. Also during 2001, we invested \$1.5 billion on our purchase of Northern Natural Series A Preferred Stock. Business acquisitions during 2001 included approximately \$595 million related to the purchase of BGSL and approximately \$40 million related to our purchase of iaxis. Proceeds from asset sales in 2001 included the sale of the Central Hudson facilities in May 2001 for \$920 million pursuant to a leveraged lease transaction, in addition to proceeds from the disposal of non-strategic Canadian assets and investments. Other investing activities in 2001 primarily include investments relating to a generation and a telecommunications lease arrangement.

Financing Activities. During 2003, cash used for financing activities totaled \$900 million. The following summarizes significant items:

- Repayments of \$128 million, net, under our revolving credit facilities.
- Long-term debt proceeds, net of issuance costs, for 2003 totaled \$2.2 billion and consisted of: (1) \$311 million associated with the October 2003 follow-on notes offering; (2) \$1,607 million associated with the August 2003 refinancing, (3) \$142 million from the delayed issuance of \$150 million in Illinois Power 11.5% Mortgage Bonds due 2010 and (4) \$159 million from the Term A loan drawn in connection with the April 2, 2003 credit facility restructuring.

- In connection with the August 2003 refinancing, we made a \$225 million cash payment to ChevronTexaco.
- Repayments of long-term debt totaled \$2.7 billion for 2003 and consisted of: (1) \$696 million prepayment of the outstanding balance under the Black Thunder financing; (2) \$609 million purchase of DHI's previously outstanding 2005/2006 public notes; (3) \$360 million prepayment of the Term B loan outstanding under DHI's restructured credit facility; (4) \$200 million prepayment of the Term A loan outstanding under DHI's restructured credit facility; (5) \$200 million in payments under the Renaissance and Rolling Hills interim financing; (6) \$190 million in payments of Illinois Power mortgage bond maturities; (7) \$100 million payment on Illinois Power's term loan; (8) \$165 million payment in full for the Generation facility capital lease; (9) \$86 million in payments on Illinois Power's transitional funding trust notes; (10) \$74 million in payments under the ABG Gas Supply credit agreement; (11) \$62 million in payments under the Black Thunder secured financing prior to its prepayment; (12) \$5 million purchase of Illinova senior notes on the open market; and (13) \$2 million in payments on the Junior Notes.
- Distributions to minority interest owners totaling \$21 million.

During 2002, cash used for financing activities totaled \$44 million. The following summarizes significant items:

- Net long-term debt proceeds consisted primarily of the February 2002 issuance by DHI of \$500 million of 8.75% senior notes due February 2012, the December 2002 issuance by Illinois Power of \$400 million of 11.5% Mortgage bonds due 2010 and proceeds from the ABG Gas Supply credit agreement;
- Repayments of long-term borrowings consisted of: (1) \$88 million in transitional funding notes relating to Illinois Power; (2) \$90 million relating to the April 2002 purchase of Northern Natural's senior unsecured notes due 2005; (3) \$92 million in principal payments related to the Black Thunder financing; (4) \$200 million relating to the July 2002 DHI 6.875% senior note repayment; (5) \$96 million relating to the July 2002 Illinois Power mortgage bond repayment; and (6) \$59 million in repayments under the ABG Gas Supply credit agreement;
- In July 2002, we completed a \$200 million interim financing secured by interests in our Renaissance and Rolling Hills merchant power generation facilities. In June 2002, we completed a \$250 million interim financing representing an advance on a portion of the proceeds from the sale of our U.K. natural gas storage facilities. In September 2002, we sold the entity that owned the Hornsea storage facility, and, in October 2002, we repaid approximately \$189 million of this interim financing with the proceeds. In November 2002, we sold the entities that owned the Rough facilities and repaid the remaining balance of this financing with a portion of the proceeds therefrom;
- Repayments of commercial paper borrowings and revolving credit facilities of Dynegy and DHI totaled approximately \$614 million in the aggregate and borrowings totaled an aggregate of approximately \$136 million under the Dynegy and DHI revolving credit facilities. During the same period, repayments of commercial paper borrowings and revolving credit facilities for Illinois Power totaled approximately \$238 million;
- Proceeds from the sale of capital stock totaled \$205 million related to ChevronTexaco's January 2002 purchase of approximately 10.4 million shares of Class B common stock pursuant to its preemptive rights under our shareholder agreement. Capital stock proceeds also include \$24 million of cash inflows associated with cash received from senior management associated with a December 2001 private placement of shares of our Class A common stock;
- In March 2002, Illinova consummated a tender offer pursuant to which it paid \$28 million in cash for approximately 73% of the then-outstanding shares of Illinois Power's preferred stock; and
- We made dividend payments of \$40 million to the holders of Class A common stock and \$15 million to the holder of Class B common stock.

During 2001, cash provided by financing activities totaled approximately \$3.5 billion. The following summarizes the significant items:

- Proceeds from long-term borrowings consisted primarily of (1) the issuance of \$496 million of 6.875% Senior Notes due April 1, 2011, net of issuance costs. Such proceeds were used to repay credit facility borrowings obtained to finance the purchase of the Central Hudson generation facilities; (2) \$282 million associated with the ABG Gas Supply credit agreement; (3) the issuance of \$187 million of variable rate pollution control bonds by Illinois Power; and (4) proceeds from lease arrangements of approximately \$340 million, which were used in the construction of two generation facilities and the U.S. fiber optic network;
- Repayments of long-term debt include \$187 million of variable rate pollution control bonds, which were repaid and retired contemporaneously with the issuance of lower rate bonds discussed above, \$87 million of transitional funding trust notes and \$30 million of Illinova's medium term notes;
- Proceeds from the sale of capital stock and from options and 401(k) plans approximated \$604 million. We sold approximately 29.8 million shares of common stock during 2001. The offerings included approximately 27.5 million shares of Class A common stock sold to the public in December 2001. We also sold approximately 1.2 million shares of Class B common stock to ChevronTexaco in private transactions pursuant to the exercise of ChevronTexaco's preemptive rights. This amount is net of underwriting commissions and expenses of approximately \$32 million;
- Proceeds of \$1.5 billion relate to the sale of 150,000 shares of Series B Preferred Stock to ChevronTexaco, concurrent with Dynegy's purchase of Northern Natural Series A Preferred Stock;
- We repurchased approximately 1.7 million shares of our outstanding Class A common stock pursuant to our stock repurchase plan at a cost of \$68 million;
- Illinois Power redeemed \$100 million of Trust Originated Preferred Securities issued by Illinois Power Financing I. The redemption was financed with \$85 million from cash on hand and \$15 million in commercial paper; and
- We made payments of dividends and other distributions totaling \$98 million.

SEASONALITY

Our revenues and operating income are subject to fluctuations during the year, primarily due to the impact seasonal factors have on sales volumes and the prices of power, natural gas, and natural gas liquids. Power marketing operations and generating facilities have higher volatility and demand, respectively, in the summer cooling months, while the regulated energy delivery business has higher seasonal gas sales in the winter and higher seasonal electricity sales in the summer. These trends may change over time as demand for natural gas increases in the summer months as a result of increased gas-fired electricity generation. Our liquids businesses are also subject to seasonal factors impacting both volumes and prices.

CRITICAL ACCOUNTING POLICIES

Our Controller's Department is responsible for the development and application of accounting policy and control procedures. This department conducts these activities independent of any active management of our risk exposures, is independent of our business segments and reports to the Chief Financial Officer.

The process of preparing financial statements in accordance with GAAP requires our management to make estimates and judgments regarding certain items and transactions. It is possible that materially different amounts could be recorded if these estimates and judgments change or if the actual results differ from these estimates and judgments. We have identified the following six critical accounting policies that require a significant amount of judgment and are considered to be the most important to the portrayal of our financial position and results of operations:

- Revenue Recognition;
- Valuation of Tangible and Intangible Assets;
- Estimated Useful Lives;
- Accounting for Contingencies;
- Accounting for Income Taxes; and
- Valuation of Pension Assets and Liabilities.

Revenue Recognition

We utilize two comprehensive accounting models in reporting our consolidated financial position and results of operations as required by GAAP – an accrual model and a fair value model. We determine the appropriate model for our operations based on guidance provided in applicable accounting standards and positions adopted by the FASB or the SEC. We have applied these accounting policies on a consistent basis during the three years in the period ended December 31, 2003, except as required by the adoption of EITF Issue 02-03, which rescinded EITF Issue 98-10.

The accrual model has historically been used to account for substantially all of the operations conducted in our GEN, NGL and REG segments. These businesses consist largely of the ownership and operation of physical assets that we use in various generation, processing and delivery operations. These processes include the generation of electricity, the separation of natural gas liquids into their component parts from a stream of natural gas and the transportation or transmission of commodities through pipelines or over transmission lines. End sales from these businesses result in physical delivery of commodities to our wholesale, commercial and industrial and retail customers. We recognize revenue from these transactions when the product or service is delivered to a customer.

The fair value model has historically been used to account for forward physical and financial transactions, primarily in the CRM and GEN segments, which meet criteria defined by the FASB or the EITF. The criteria are complex, but generally require these contracts to relate to future periods, to contain fixed price and volume components and to have terms that require or permit net settlement of the contract in cash or the equivalent. The FASB determined that the fair value model is the most appropriate method for accounting for these types of contracts. In part, this conclusion is based on the cash settlement provisions in these agreements, as well as the volatility in commodity prices, interest rates and, if applicable, foreign exchange rates, which impact the valuation of these contracts. Since these transactions may be settled in cash or the equivalent, the value of the assets and liabilities associated with these transactions is reported at estimated settlement value based on current prices and rates as of each balance sheet date.

We estimate the fair value of our marketing portfolio using a liquidation value approach assuming that the ability to transact business in the market remains at historical levels. The estimated fair value of the portfolio is

computed by multiplying all existing positions in the portfolio by estimated prices, reduced by a LIBOR-based time value of money adjustment and deduction of reserves for credit and price. The estimated prices in this valuation are based either on (1) prices obtained from market quotes, when there are an adequate number of quotes to consider the period liquid, or, if market quotes are unavailable, or the market is not considered to be liquid, (2) prices from a proprietary model which incorporates forward energy prices derived from market quotes and values from executed transactions. The amounts recorded as revenue change as these estimates are revised to reflect actual results and changes in market conditions or other factors, many of which are beyond our control.

Under SFAS No. 133, as amended, derivative contracts can be accounted for in three different ways: (1) as an accrual contract, if the criteria for the "normal purchase normal sale" exemption are met and documented; (2) as a cash flow or fair value hedge, if the criteria are met and documented; or (3) as a mark-to-market contract with changes in fair value recognized in current period earnings. Generally, we only mark-to-market through earnings our derivative contracts if they do not qualify for the "normal purchase normal sale" exemption or as a cash flow hedge. Because derivative contracts can be accounted for in three different ways, as the "normal purchase normal sale" exemption and cash flow hedge accounting are elective, the accounting treatment used by another party for a similar transaction could be different than the accounting treatment we use.

Valuation of Tangible and Intangible Assets

We evaluate long-lived assets, such as property, plant and equipment, investments and goodwill, when events or changes in circumstances lead to a reduction in the estimated useful lives or estimated future cash flows sufficient to indicate that the carrying value of such assets may not be recoverable. Factors we consider important, which could trigger an impairment analysis, include, among others:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of our use of the assets or the strategy for our overall business;
- significant negative industry or economic trends; and
- significant declines in stock value for a sustained period.

We assess the carrying value of our property, plant and equipment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." If a long-lived asset is held and used, the determination of whether an impairment has occurred is based on an estimate of undiscounted cash flows attributable to the assets, as compared to the carrying value of the assets. If an impairment has occurred, the amount of the impairment loss recognized would be determined by estimating the fair value of the assets and recording a loss if the fair value is less than the book value. For assets identified as held for sale, the book value is compared to the estimated fair value to determine if an impairment loss is required.

We follow the guidance of APB 18, "The Equity Method of Accounting for Investments in Common Stock," and SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," when reviewing our investments. The book value of the investment is compared to the estimated fair value, based either on discounted cash flow projections or quoted market prices, if available, to determine if an impairment is required. We record a loss when the decline in value is considered other than temporary. We follow the guidance set forth in SFAS No. 142, "Goodwill and Other Intangible Assets," when assessing the carrying value of our goodwill. Accordingly, we evaluate our goodwill for impairment on an annual basis or when events warrant an assessment. Fair value utilized in this assessment is also based on our estimate of future cash flows.

Our assessment regarding the existence of impairment factors is based on market conditions, operational performance and legal factors impacting our businesses. Our review of factors present and the resulting estimation of the appropriate carrying value of our property, plant and equipment, investments and goodwill are subject to judgments and estimates that management is required to make. Our fair value estimates are impacted significantly by the estimated useful lives of the assets, commodity prices, regulations and discount rate assumptions. If different judgments were applied to fair value calculations, the fair value estimate, and potential resulting impairment, could differ from our estimate. Actual results could vary materially from these estimates.

Estimated Useful Lives

The estimated useful lives of our long-lived assets are used to compute depreciation expense and are also used for impairment testing. Estimated useful lives are based on the assumption that we provide an appropriate level of capital expenditures while the assets are still in operation. Without these continued capital expenditures, the useful lives of these assets could decrease significantly. These estimates could be impacted by future energy prices, environmental regulations and competition. If the useful lives of these assets were found to be shorter than originally estimated, depreciation charges would be accelerated.

Accounting for Contingencies

We are involved in numerous lawsuits, claims, proceedings, joint venture audits and tax-related audits in the normal course of our operations. In accordance with SFAS No. 5, we record a loss contingency for these matters when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We review our loss contingencies on an ongoing basis to ensure that we have appropriate reserves recorded on the balance sheet. These reserves are based on judgments made by management with respect to the likely outcome of these matters, including any applicable insurance coverage for litigation matters, and are adjusted as circumstances warrant. Our judgment could change based on new information, changes in laws or regulations, changes in management's plans or intentions, the outcome of legal proceedings, settlements or other factors. If different judgments were applied with respect to these matters, it is likely that reserves would be recorded for different amounts.

Liabilities are recorded when environmental assessment indicates that remedial efforts are probable and the costs can be reasonably estimated. Measurement of liabilities is based on relevant past experience, currently enacted laws and regulations, existing technology, site-specific costs and cost-sharing arrangements. Recognition of any joint and several liability is based upon our best estimate of our final pro-rata share of such liability. Any changes in assumptions could lead to increases or decreases in our ultimate liability, with any such changes recognized immediately in earnings.

Under the provisions of SFAS No. 143, "Asset Retirement Obligations," we are required to record legal obligations to retire tangible, long-lived assets on our balance sheet as liabilities, which are recorded at a discount, when the liability is incurred. Significant judgment is involved in estimating our future cash flows associated with such obligations, as well as the ultimate timing of the cash flows. If our estimates on the amount or timing of the cash flow change, the change is recognized immediately in earnings.

Accounting for Income Taxes

We follow the guidance in SFAS No. 109, "Accounting for Income Taxes," which requires that we use the asset and liability method of accounting for deferred income taxes and provide deferred income taxes for all significant temporary differences. Please read Note 14—Income Taxes beginning on page F-45 for further discussion.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as depreciation, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets.

We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that it is more likely than not (a likelihood of more than 50%) that some portion or all of the deferred tax assets will not be realized, we must establish a valuation allowance. We consider all available evidence, both positive and negative, to determine whether, based on the weight of the evidence, a

valuation allowance is needed. Evidence used includes information about our current financial position and our results of operations for the current and preceding years, as well as all currently available information about future years, including our anticipated future performance, the reversal of deferred tax liabilities and tax planning strategies. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, we must include an expense or benefit within the tax provisions in the consolidated statements of operations. Significant management judgment is required in determining any valuation allowance recorded against our deferred tax assets.

We have recorded deferred tax assets principally resulting from net operating losses, AMT credits and capital losses. As of December 31, 2003 and 2002, deferred tax assets related to net operating losses totaled \$572 million and \$224 million, respectively. As of December 31, 2003 and 2002, deferred tax assets related to AMT credits totaled \$218 million. We have not established a valuation allowance against these net operating losses or AMT credits, as we believe that it is more likely than not that these deferred tax assets will be realized. We expect that future sources of taxable income, including the sale of Illinois Power, reversing temporary differences and other tax planning strategies will be sufficient to realize these assets. While we have considered these factors in assessing the need for a valuation allowance, there is no assurance that a valuation allowance would not need to be established in the future if information about future years change. Any change in the valuation allowance would impact our income tax provision and net income in the period in which such a determination is made.

As of December 31, 2003 and 2002, deferred tax assets related to capital losses totaled \$194 million and \$223 million, respectively, and valuation allowances recorded related to these losses totaled \$135 million and \$171 million, respectively. In 2003, we reduced the valuation allowance by \$36 million based on capital gains recognized in 2003 or anticipated to be recognized in early 2004 related to various dispositions, excluding our sale of our interest in Joppa, which is subject to regulatory approval. Any changes in the valuation allowance would impact our income tax provision and net income in the period in which such a determination is made. Please see Note 14—Income Taxes beginning on page F-45 for a discussion of the change in our valuation allowance.

Valuation of Pension Assets and Liabilities

Our pension and post-retirement benefit costs are developed from actuarial valuations. Inherent in these valuations are key assumptions provided by us to our actuaries, including the discount rate and expected long-term rate of return on plan assets. Material changes in our pension and post-retirement benefit costs may occur in the future due to changes in these assumptions, changes in the number of plan participants and changes in the level of benefits provided.

The discount rate is subject to change each year, consistent with changes in applicable high-quality, long-term corporate bond indices. Long-term interest rates declined during 2003. Accordingly, at December 31, 2003, we used a discount rate of 6.0%, a decline of 50 basis points from the 6.5% rate used as of December 31, 2002. This decline in the discount rate had the impact of increasing the underfunded status of our pension plans by approximately \$44 million.

The expected long-term rate of return on pension plan assets is selected by taking into account the expected duration of the projected benefit obligation for the plans, the asset mix of the plans and the fact that the plan assets are actively managed to mitigate downside risk. Based on these factors, our expected long-term rate of return as of January 1, 2004 is 8.75%, compared with 9.00% during 2003. This change did not impact 2003 pension expense, but it will adversely impact pension expense beginning in 2004. We expect the decrease in this assumption, coupled with the decreased discount rate discussed above and the passage of time, will increase 2004 pension expense by approximately \$15 million over 2003 expense.

On December 31, 2003, our annual measurement date, the accumulated benefit obligation related to our pension plans exceeded the fair value of the pension plan assets (such excess is referred to as an unfunded

accumulated benefit obligation). This difference is attributed to (1) an increase in the accumulated benefit obligation that resulted from the decrease in the discount rate and the expected long-term rate of return and (2) a decline in the fair value of the plan assets due to a sharp decrease in the equity markets through December 31, 2002, which was partially recovered during 2003. As a result, in accordance with SFAS No. 87, "Employers' Accounting for Pensions," as of December 31, 2003, we have recognized a charge to accumulated other comprehensive loss of \$57 million (net of taxes of \$33 million), which decreases stockholders' equity. The charge to stockholders' equity for the excess of additional pension liability over the unrecognized prior service cost represents a net loss not yet recognized as pension expense.

The following table summarizes the sensitivity of pension expense and our projected benefit obligation, or PBO, to changes in the discount rate and the expected long-term rate of return on pension assets:

	Impact on PBO, December 31, 2004	Impact on 2004 Expense
	(in millions)	
Increase Discount Rate 50 basis points	\$(58.5)	\$(5.3)
Decrease Discount Rate 50 basis points	64.6	5.7
Increase Expected Rate of Return 50 basis points	—	(3.2)
Decrease Expected Rate of Return 50 basis points	—	3.2

We expect to make \$8 million in cash contribution related to our pension plans during 2004. In addition, it is likely that we will be required to continue to make contributions to the pension plan beyond 2004. Although it is difficult to estimate these potential future cash requirements due to uncertain market conditions, we currently expect that the cash requirements would be approximately \$57 million in 2005 and \$46 million in 2006.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 2—Accounting Policies—Accounting Principles Adopted beginning on page F-16 for a discussion of recently issued accounting pronouncements affecting us. Specifically, we adopted the net presentation provisions of EITF Issue 02-03 in the third quarter 2002 and we adopted the provision within EITF Issue 02-03 that rescinds EITF Issue 98-10 effective January 1, 2003. We also adopted SFAS No. 143 effective January 1, 2003. We adopted SFAS No. 150 and EITF Issue 03-11 effective July 1, 2003. We adopted portions of FIN 46R, as required by GAAP, effective December 31, 2003.

RISK-MANAGEMENT DISCLOSURES

The following table provides a reconciliation of the risk-management data on the consolidated balance sheets, statements of operations and statements of cash flows:

	As of and for the Year Ended December 31, 2003 (in millions)
Balance Sheet Risk-Management Accounts	
Fair value of portfolio at January 1, 2003	\$ 363
Risk-management losses recognized through the income statement in the period, net (1)	(184)
Cash received related to risk-management contracts settled in the period, net (2)	(260)
Changes in fair value as a result of a change in valuation technique (3)	—
Non-cash adjustments and other (4)	(56)
Fair value of portfolio at December 31, 2003	<u>\$ (137)</u>
Income Statement Reconciliation	
Risk-management losses recognized through the income statement in the period, net (1)	\$(184)
Physical business recognized through the income statement in the period, net (5)	(130)
Non-cash adjustments and other	5
Net recognized operating loss	<u>\$ (309)</u>
Cash Flow Statement	
Cash received related to risk-management contracts settled in the period, net (2)	\$ 260
Estimated cash paid related to physical business settled in the period, net (5)	(130)
Timing and other, net (6)	(57)
Cash received during the period	<u>\$ 73</u>
Risk-Management cash flow adjustment for the year ended December 31, 2003 (7)	<u>\$ 382</u>

- (1) This amount consists primarily of \$121 million in mark-to-market losses on contracts associated with the Sithe Independence power tolling arrangement and a \$30 million loss associated with the settlement of power supply agreements with Kroger.
- (2) This amount consists primarily of the Kroger settlement of approximately \$110 million and cash received due to the wind-down of our CRM business.
- (3) Our modeling methodology has been consistently applied.
- (4) This amount primarily consists of approximately \$97 million of risk-management assets that were removed from the risk-management accounts at January 1, 2003 in conjunction with the adoption of certain provisions of EITF Issue 02-03. This amount is offset primarily by changes in value associated with cash flow hedges.
- (5) This amount consists primarily of capacity payments on our power tolling arrangements.
- (6) This amount consists primarily of cash paid in connection with the settlement of cash flow hedges.
- (7) This amount is calculated as "Cash received during the period" less "Net recognized operating loss."

The net risk management liability of \$137 million is the aggregate of the following line items on the consolidated balance sheets: Current Assets—Assets from risk-management activities, Other Assets—Assets from risk-management activities, Current Liabilities—Liabilities from risk-management activities and Other Liabilities—Liabilities from risk-management activities.

Risk-Management Asset and Liability Disclosures

The following table depicts the mark-to-market value and cash flow components, based on contract terms, of our net risk-management assets and liabilities at December 31, 2003. As opportunities arise to monetize positions that we believe will result in an economic benefit to us, we may receive or pay cash in periods other than those depicted below.

Net Risk-Management Asset and Liability Disclosures

	<u>Total</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Thereafter</u>
	(in millions)						
Mark-to-Market (1)	\$(144)	\$(22)	\$(17)	\$(25)	\$(39)	\$(12)	\$(29)
Cash Flow (2)	(152)	(17)	(14)	(24)	(43)	(15)	(39)

- (1) Mark-to-market reflects the fair value of our risk-management asset position, which considers time value, credit, price and other reserves necessary to determine fair value. These amounts exclude the fair value associated with certain derivative instruments designated as hedges. The net risk-management liabilities at December 31, 2003 of \$137 million on the consolidated balance sheets includes the \$144 million herein as well as hedging instruments. Cash flows have been segregated between periods based on the delivery date required in the individual contracts.
- (2) Cash Flow reflects undiscounted cash inflows and outflows by contract based on the tenor of individual contract position for the remaining periods. These anticipated undiscounted cash flows have not been adjusted for counterparty credit or other reserves. These amounts exclude the cash flows associated with certain derivative instruments designated as hedges.

The following table provides an assessment of net contract values by year as of December 31, 2003, based on our valuation methodology.

Net Fair Value of Risk-Management Portfolio

	<u>Total</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Thereafter</u>
	(in millions)						
Market Quotations (1)	\$ (69)	\$(22)	\$(20)	\$—	\$(25)	\$ (1)	\$ (1)
Prices Based on Models (2)	(75)	—	3	(25)	(14)	(11)	(28)
Total	<u>\$(144)</u>	<u>\$(22)</u>	<u>\$(17)</u>	<u>\$(25)</u>	<u>\$(39)</u>	<u>\$(12)</u>	<u>\$(29)</u>

- (1) Prices obtained from actively traded, liquid markets for commodities other than natural gas positions. All natural gas positions for all periods are contained in this line based on available market quotations.
- (2) See discussion of our use of long-term models in "Critical Accounting Policies" beginning on page 71.

Derivative Contracts

The absolute notional contract amounts associated with our commodity risk-management, interest rate and foreign currency exchange contracts are discussed in Item 7A. Quantitative and Qualitative Disclosures About Market Risk beginning on page 80.

UNCERTAINTY OF FORWARD-LOOKING STATEMENTS AND INFORMATION

This Form 10-K includes statements reflecting assumptions, expectations, projections, intentions or beliefs about future events that are intended as "forward-looking statements." All statements included or incorporated by reference in this annual report, other than statements of historical fact, that address activities, events or developments that we or our management expect, believe or anticipate will or may occur in the future are forward-looking statements. These statements represent our reasonable judgment on the future based on various factors and using numerous assumptions and are subject to known and unknown risks, uncertainties and other factors that could cause our actual results and financial position to differ materially from those contemplated by the statements. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as "anticipate," "estimate," "project," "forecast," "plan," "may," "will," "should," "expect" and other words of similar meaning. In particular, these include, but are not limited to, statements relating to the following:

- projected operating or financial results, include anticipated cash flows from operations and asset sale proceeds for 2004;
- expectations regarding capital expenditures, interest expense and other payments;
- our ability to execute the cost-savings measures we have identified;
- our beliefs and assumptions relating to our liquidity position, including our ability to satisfy or refinance our significant debt maturities and other obligations as they come due, particularly the February 2005 maturity of our \$1.1 billion revolving credit facility;
- our ability to address our substantial leverage;
- our ability to compete effectively for market share with industry participants;
- beliefs about the outcome of legal and administrative proceedings, including matters involving the western power and natural gas markets, shareholder claims and environmental and master netting agreement matters, as well as the investigations primarily relating to Project Alpha and our past trading practices;
- our ability to consummate the disposition of specified non-strategic assets on the terms and in the timeframes anticipated, particularly the agreed upon sale of Illinois Power to Ameren; and
- our ability to complete our exit from the CRM business and the costs associated with this exit.

Any or all of our forward-looking statements may turn out to be wrong. They can be affected by inaccurate assumptions or by known or unknown risks, uncertainties and other factors including, among others:

- the timing and extent of changes in weather and commodity prices, particularly for power, natural gas, natural gas liquids and other fuels, as such as the frac spread and, to a lesser extent, the natural gas spark spread;
- the effects of competition in our asset-based business lines;
- the effects of the proposed sale of specified non-strategic assets, particularly the agreed upon sale of Illinois Power to Ameren;
- the condition of the capital markets generally, which will be affected by interest rates, foreign currency fluctuations and general economic conditions, and our financial condition, including our ability to satisfy our significant debt maturities;
- our ability to realize our significant deferred tax assets, including loss carryforwards;
- the effectiveness of our risk-management policies and procedures and the ability of our counterparties to satisfy their financial commitments;

- the liquidity and competitiveness of wholesale trading markets for energy commodities, particularly natural gas, electricity and natural gas liquids;
- operational factors affecting the start up or ongoing commercial operations of our power generation, natural gas and natural gas liquids and regulated energy delivery facilities, including catastrophic weather-related damage, regulatory approvals, permit issues, unscheduled blackouts, outages or repairs, unanticipated changes in fuel costs or availability of fuel emission credits, the unavailability of gas transportation and the unavailability of electric transmission service or workforce issues;
- increased interest expense and the other effects of our 2003 restructuring and refinancing transactions, including the security arrangements and restrictive covenants contained in the related financing agreements;
- counterparties' collateral demands and other factors affecting our liquidity position and financial condition;
- our ability to operate our businesses efficiently, manage capital expenditures and costs (including general and administrative expenses) tightly and generate earnings and cash flow from our asset-based businesses in relation to our substantial debt and other obligations;
- the direct or indirect effects on our business of any further downgrades in our credit ratings (or actions we may take in response to changing credit ratings criteria), including refusal by counterparties to enter into transactions with us and our inability to obtain credit or capital in amounts or on terms that are considered favorable;
- the costs and other effects of legal and administrative proceedings, settlements, investigations and claims, including legal proceedings related to the western power and natural gas markets, shareholder claims, claims arising out of the CRM business and environmental liabilities that may not be covered by indemnity or insurance, as well as the FERC, U.S. Attorney and other similar investigations primarily surrounding Project Alpha and our past trading practices;
- other North American regulatory or legislative developments that affect the regulation of the electric utility industry, the demand and pricing for energy generally, increase in the environmental compliance cost for our facilities or that impose liabilities on the owners of such facilities; and
- general political conditions and developments in the United States and in foreign countries whose affairs affect our asset-based businesses including any extended period of war or conflict.

In addition, there may be other factors that could cause our actual results to be materially different from the results referenced in the forward-looking statements, some of which are included elsewhere in this Form 10-K. Many of these factors will be important in determining our actual future results. Consequently, no forward-looking statement can be guaranteed. Our actual future results may vary materially from those expressed or implied in any forward-looking statements.

All forward-looking statements contained in this Form 10-K are qualified in their entirety by this cautionary statement. Forward-looking statements speak only as of the date they are made, and we disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of this Form 10-K, except as otherwise required by applicable law.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to commodity price variability related to our power generation and natural gas liquids businesses. In addition, fuel requirements at our power generation, gas processing and fractionation facilities represent additional commodity price risks to us. In order to manage these commodity price risks, we routinely utilize various fixed-price forward purchase and sales contracts, futures and option contracts traded on the New York Mercantile Exchange and swaps and options traded in the over-the-counter financial markets to:

- manage and hedge our fixed-price purchase and sales commitments;
- reduce our exposure to the volatility of cash market prices; and
- hedge our fuel requirements for our generating facilities and natural gas processing plants.

The potential for changes in the market value of our commodity, interest rate and currency portfolios is referred to as "market risk." A description of each market risk category is set forth below:

- Commodity price risks result from exposures to changes in spot prices, forward prices and volatilities in commodities, such as electricity, natural gas, natural gas liquids and other similar products;
- Interest rate risks primarily result from exposures to changes in the level, slope and curvature of the yield curve and the volatility of interest rates; and
- Currency rate risks result from exposures to changes in spot prices, forward prices and volatilities in currency rates.

In the past, we have attempted to manage these market risks through diversification, controlling position sizes and executing hedging strategies. The ability to manage an exposure may, however, be limited by adverse changes in market liquidity, our credit capacity or other factors.

VaR. In addition to applying business judgment, senior management uses a number of quantitative tools to monitor our exposure to market risk. These tools include stress and scenario analyses performed periodically that measure the potential effects of various market events, including substantial swings in volatility factors, absolute commodity price changes and the impact of interest rate movements.

The modeling of the risk characteristics of our mark-to-market portfolio involves a number of assumptions and approximations. We estimate VaR using a JP Morgan RiskMetrics™ approach assuming a one-day holding period. Inputs for the VaR calculation are prices, positions, instrument valuations and the variance-covariance matrix. While management believes that these assumptions and approximations are reasonable, there is no uniform industry methodology for estimating VaR, and different assumptions and/or approximations could produce materially different VaR estimates.

We use historical data to estimate our VaR and, to better reflect current asset and liability volatilities, this historical data is weighted to give greater importance to more recent observations. Given our reliance on historical data, VaR is effective in estimating risk exposures in markets in which there are not sudden fundamental changes or shifts in market conditions. An inherent limitation of VaR is that past changes in market risk factors, even when weighted toward more recent observations, may not produce accurate predictions of future market risk. VaR should be evaluated in light of this and the methodology's other limitations.

VaR represents the potential loss in value of our mark-to-market portfolio due to adverse market movements over a defined time horizon within a specified confidence level. For the VaR numbers reported below, a one-day time horizon and a 95% confidence level were used. This means that there is a one in 20 statistical chance that the daily portfolio value will fall below the expected maximum potential reduction in portfolio value at least as large as the reported VaR. Thus, a change in portfolio value greater than the expected change in portfolio value on a single trading day would be anticipated to occur, on average, about once a month. Gains or losses on a single day can exceed reported VaR by significant amounts. Gains or losses can also accumulate over a longer time horizon such as a number of consecutive trading days.

In addition, we have provided our VaR using a one-day time horizon and a 99% confidence level. The purpose of this disclosure is to provide an indication of earnings volatility using a higher confidence level. Under this presentation, there is a one in 100 statistical chance that the daily portfolio value will fall below the expected maximum potential reduction in portfolio value at least as large as the reported VaR. We have also disclosed a two-year comparison of daily VaR in order to provide context for the one-day amounts. Average VaR is not available for 2002 due to the restatement of historical results. While VaR can be calculated at a single point in time, it is not feasible to recalculate the historical results necessary to calculate an average.

The following table sets forth the aggregate daily VaR of the mark-to-market portion of our risk-management portfolio primarily associated with the GEN and CRM segments.

Daily and Average VaR for Risk-Management Portfolio

	December 31, 2003	December 31, 2002
	(in millions)	
One Day VaR—95% Confidence Level	\$4	\$ 8
One Day VaR—99% Confidence Level	\$6	\$ 11
Average VaR for the Year-to-Date Period—95% Confidence Level (1)	\$6	N/A

(1) Average VaR is not available for 2002 due to the restatement of historical results.

Credit Risk. Credit risk represents the loss that we would incur if a counterparty fails to perform pursuant to the terms of its contractual obligations. To reduce our credit exposure, we execute agreements that permit us to offset receivables, payables and mark-to-market exposure. We attempt to further reduce credit risk with certain counterparties by obtaining third-party guarantees or collateral as well as the right of termination in the event of default.

Our Credit Department, based on guidelines approved by the Board of Directors, establishes our counterparty credit limits. Our industry typically operates under negotiated credit lines for physical delivery and financial contracts. Our credit risk system provides current credit exposure to counterparties on a daily basis.

The following table represents our credit exposure at December 31, 2003 associated with the mark-to-market portion of our risk-management portfolio, on a net basis.

Credit Exposure Summary

	Investment Grade Quality	Non-Investment Grade Quality	Total
	(in millions)		
Type of Business:			
Financial Institutions	\$151	\$—	\$151
Commercial/Industrial/End Users	56	42	98
Utility and Power Generators	18	—	18
Oil and Gas Producers	41	8	49
Other	—	1	1
Total	<u>\$266</u>	<u>\$ 51</u>	<u>\$317</u>

Of the \$51 million in credit exposure to non-investment grade counterparties, approximately 92% (\$47 million) is collateralized or subject to other credit exposure protection.

Interest Rate Risk. Interest rate risk primarily results from variable rate debt obligations and, since changing interest rates impact the discounted value of future cash flows, changes in the value of our risk management portfolios. Management continues to monitor our exposure to fluctuations in interest rates and may execute swaps or other financial instruments to change our risk profile for this exposure.

As of December 31, 2003, our fixed rate debt instruments as a percentage of total debt instruments was equal to 91%. Based on sensitivity analysis of the variable rate financial obligations in our debt portfolio as of December 31, 2003, it is estimated that a one percentage point interest rate movement in the average market interest rates (either higher or lower) over the 12 months ended December 31, 2004 would either decrease or increase income before taxes by approximately \$6 million. Hedging instruments that impact such interest rate exposure are included in the sensitivity analysis. Over time, we may seek to reduce the percentage of fixed rate financial obligations in our debt portfolio through the use of swaps or other financial instruments.

As we continue to execute our restructuring strategy, our interest rate risk associated with providing risk-management services to customers has declined significantly. The following table sets forth the daily and average VaR associated with the interest rate component of the risk-management portfolio. We seek to manage our interest rate exposure through application of various hedging strategies. Hedging instruments executed to mitigate such interest rate exposure in the risk-management portfolio are included in the VaR as of December 31, 2003 and December 31, 2002 and are reflected in the table below.

Daily and Average VaR on Interest Component of Risk-Management Portfolio

	December 31, 2003	December 31, 2002
	(in millions)	
One Day VaR—95% Confidence Level	\$0.6	\$2.5
Average VaR for the Year-to-Date Period—95% Confidence Level (1)	\$1.5	N/A

(1) Average VaR is not available for 2002 due to the restatement of historical results.

The decrease in One Day VaR is due to the wind down of the CRM business and the resulting decrease in the size of our risk-management portfolio.

Foreign Currency Exchange Rate Risk. Foreign currency risk arises from our investments in affiliates and subsidiaries owned and operated in foreign countries. Such risk is also a result of risk management transactions with customers in countries outside the United States. Management continually monitors our exposure to fluctuations in foreign currency exchange rates. When possible, contracts are denominated in or indexed to the U.S. dollar, or such risk may be hedged through debt denominated in the foreign currency or through financial contracts.

At December 31, 2003, our primary foreign currency exchange rate exposures were the U.K. Pound, Canadian Dollar and European Euro. Due to the sale of the U.K. natural gas storage assets in 2002, DGC Europe in January 2003, as well as the wind down of the U.K. CRM business through the first half of 2003, our foreign currency exchange risk has declined significantly since December 31, 2002.

The following table sets forth the daily and average foreign currency exchange VaR. Hedging instruments executed to mitigate such foreign currency exchange exposure are included in the VaR as of December 31, 2003 and December 31, 2002 and are reflected in the table below.

Daily and Average Foreign Currency Exchange VaR

	December 31, 2003	December 31, 2002
	(in millions)	
One Day VaR—95% Confidence Level	\$0.2	\$0.4
Average VaR for the Year-to-Date Period—95% Confidence Level	\$0.3	\$2.9

Derivative Contracts. The absolute notional financial contract amounts associated with our commodity risk-management, interest rate and foreign currency exchange contracts were as follows at December 31, 2003 and December 31, 2002, respectively:

Absolute Notional Contract Amounts

	December 31, 2003	December 31, 2002
Natural Gas (Trillion Cubic Feet)	2.364	7.910
Electricity (Million Megawatt Hours)	8.713	64.563
Natural Gas Liquids (Million Barrels)	—	0.265
Fair Value Hedge Interest Rate Swaps (In Millions of U.S. Dollars)	\$ 25	\$ 601
Fixed Interest Rate Received on Swaps (%)	5.706	5.616
Cash Flow Hedge Interest Rate Swaps (In Millions of U.S. Dollars)	\$ 405	\$ 1,566
Fixed Interest Rate Paid on Swaps (%)	3.448	2.824
Interest Rate Risk-Management Contract (In Millions of U.S. Dollars)	\$ 306	\$ 1,001
Fixed Interest Rate Paid (%)	5.570	5.530
U.K. Pound Sterling (In Millions of U.S. Dollars)	\$ —	\$ 198
Average U.K. Pound Sterling Contract Rate (In U.S. Dollars)	\$ —	\$ 1.574
Euro Dollars (In Millions of U.S. Dollars)	\$ —	\$ 5
Average Euro Contract Rate (In U.S. Dollars)	\$ —	\$ 1.212
Canadian Dollar (In Millions of U.S. Dollars)	\$ —	\$ 523
Average Canadian Dollar Contract Rate (In U.S. Dollars)	\$ —	\$0.7140

Item 8. Financial Statements and Supplementary Data

Our financial statements and financial statement schedules are set forth at pages F-1 through F-85 inclusive, found at the end of this annual report, and are incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Effective as of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). This evaluation included consideration of our establishment of a disclosure committee and the various processes carried out under the direction of this committee in an effort to ensure that information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified by the SEC. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective and designed to ensure that the information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the requisite time periods. While our disclosure controls and procedures provide reasonable assurance that the appropriate information will be available on a timely basis, this assurance is subject to limitations inherent in any control system, no matter how well it may be designed or administered.

Changes in Internal Controls. There was no change in our internal controls over financial reporting (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) identified in connection with the evaluation of our internal controls performed during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART III

Item 10. Directors and Executive Officers of the Registrant

Executive Officers. The information required by this Item 10 with respect to our executive officers is set forth in Part I of this annual report under the caption Item 1A. Executive Officers beginning on page 29, which information is incorporated herein by this reference.

Code of Ethics. We have adopted a Code of Ethics within the meaning of Item 406(b) of Regulation S-K. This Code of Ethics applies to our chief executive officer, chief financial officer, controller and other persons performing similar functions designated by the chief financial officer, and is filed as an exhibit to this Form 10-K.

Other Information. The other information required by this Item 10 will be contained in our definitive proxy statement for our 2004 annual meeting of shareholders under the headings "Proposal 1—Election of Directors" and "Executive Compensation—Section 16(a) Beneficial Ownership Reporting Compliance" and is incorporated herein by reference. The proxy statement will be filed with the SEC not later than 120 days after December 31, 2003.

Item 11. Executive Compensation

Information with respect to executive compensation will be contained in the upcoming proxy statement under the heading "Executive Compensation" and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Information regarding ownership of our outstanding securities will be contained in the upcoming proxy statement under the heading "Principal Stockholders" and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

Information regarding related party transactions will be contained in the upcoming proxy statement under the headings "Principal Stockholders," "Proposal 1—Election of Directors" and "Executive Compensation—Indebtedness of Management" and "—Certain Relationships and Related Transactions" and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services will be contained in the upcoming proxy statement under the heading "Independent Auditors" and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents, which we have filed with the SEC pursuant to the Securities Exchange Act of 1934, as amended, are by this reference incorporated in and made a part of this annual report:

1. Financial Statements—Our consolidated financial statements are incorporated under Item 8. of this annual report.
2. Financial Statement Schedules—Financial Statement Schedules are incorporated under Item 8. of this annual report.
3. Exhibits—The following instruments and documents are included as exhibits to this annual report. All management contracts or compensation plans or arrangements set forth in such list are marked with a ††.

<u>Exhibit Number</u>	<u>Description</u>
3.1	—Amended and Restated Articles of Incorporation of Dynegy Inc. (incorporated by reference to Appendix A to the Definitive Proxy Statement on Schedule 14A of Dynegy Inc., File No. 1-15659, filed with the SEC on April 25, 2001).
3.2	—Statement of Resolution Establishing Series of Series C Convertible Preferred Stock of Dynegy Inc. (incorporated by reference to Exhibit 4.1 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
**3.3	—Amended and Restated Bylaws of Dynegy Inc.
4.1	—Indenture, dated as of December 11, 1995, by and among NGC Corporation, the Subsidiary Guarantors named therein and the First National Bank of Chicago, as Trustee (incorporated by reference to exhibits to the Registration Statement on Form S-3 of NGC Corporation, Registration No. 33-97368).
4.2	—First Supplemental Indenture, dated as of August 31, 1996, by and among NGC Corporation, the Subsidiary Guarantors named therein and The First National Bank of Chicago, as Trustee, supplementing and amending the Indenture dated as of December 11, 1995 (incorporated by reference to Exhibit 4.4 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 1996 of NGC Corporation, File No. 1-11156).
4.3	—Second Supplemental Indenture, dated as of October 11, 1996, by and among NGC Corporation, the Subsidiary Guarantors named therein and The First National Bank of Chicago, as Trustee, supplementing and amending the Indenture dated as of December 11, 1995 (incorporated by reference to Exhibit 4.5 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 1996 of NGC Corporation, File No. 1-11156).
4.4	—Subordinated Debenture Indenture between NGC Corporation and The First National Bank of Chicago, as Debenture Trustee, dated as of May 28, 1997 (incorporated by reference to Exhibit 4.5 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 1997 of NGC Corporation, File No. 1-11156).
4.5	—Amended and Restated Declaration of Trust among NGC Corporation, Wilmington Trust Company, as Property Trustee and Delaware Trustee, and the Administrative Trustees named therein, dated as of May 28, 1997 (incorporated by reference to Exhibit 4.6 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 1997 of NGC Corporation, File No. 1-11156).
4.6	—Series A Capital Securities Guarantee Agreement executed by NGC Corporation and The First National Bank of Chicago, as Guarantee Trustee, dated as of May 28, 1997 (incorporated by reference to Exhibit 4.9 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 1997 of NGC Corporation, File No. 1-11156).

**Exhibit
Number**

Description

- 4.7 —Common Securities Guarantee Agreement of NGC Corporation dated as of May 28, 1997 (incorporated by reference to Exhibit 4.10 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 1997 of NGC Corporation, File No. 1-11156).
- 4.8 —Registration Rights Agreement, dated as of May 28, 1997, among NGC Corporation, NGC Corporation Capital Trust I, Lehman Brothers, Salomon Brothers Inc. and Smith Barney Inc. (incorporated by reference to Exhibit 4.11 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 1997 of NGC Corporation, File No. 1-11156).
- 4.9 —Fourth Supplemental Indenture among NGC Corporation, Destec Energy, Inc. and The First National Bank of Chicago, as Trustee, dated as of June 30, 1997, supplementing and amending the Indenture dated as of December 11, 1995 (incorporated by reference to Exhibit 4.12 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 1997 of NGC Corporation, File No. 1-11156).
- 4.10 —Fifth Supplemental Indenture among NGC Corporation, The Subsidiary Guarantors named therein and The First National Bank of Chicago, as Trustee, dated as of September 30, 1997, supplementing and amending the Indenture dated as of December 11, 1995 (incorporated by reference to Exhibit 4.18 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1997 of NGC Corporation, File No. 1-11156).
- 4.11 —Sixth Supplemental Indenture among NGC Corporation, The Subsidiary Guarantors named therein and The First National Bank of Chicago, as Trustee, dated as of January 5, 1998, supplementing and amending the Indenture dated as of December 11, 1995 (incorporated by reference to Exhibit 4.19 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1997 of NGC Corporation, File No. 1-11156).
- 4.12 —Seventh Supplemental Indenture among NGC Corporation, The Subsidiary Guarantors named therein and The First National Bank of Chicago, as Trustee, dated as of February 20, 1998, supplementing and amending the Indenture dated as of December 11, 1995 (incorporated by reference to Exhibit 4.20 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1997 of NGC Corporation, File No. 1-11156).
- 4.13 —Indenture, dated as of September 26, 1996, restated as of March 23, 1998, and amended and restated as of March 14, 2001, between Dynegy Holdings Inc. and Bank One Trust Company, National Association, as Trustee (incorporated by reference to Exhibit 4.17 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2000 of Dynegy Holdings Inc., File No. 0-29311).
- 4.14 —Exchange and Registration Rights Agreement (Preferred Stock) dated August 11, 2003 between Dynegy Inc. and Chevron U.S.A. Inc. (incorporated by reference to Exhibit 4.2 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 4.15 —Exchange and Registration Rights Agreement (Notes) dated August 11, 2003 between Dynegy Inc. and Chevron U.S.A. Inc. (incorporated by reference to Exhibit 4.3 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 4.16 —Amended and Restated Registration Rights Agreement (Common Stock) dated August 11, 2003 between Dynegy Inc. and Chevron U.S.A. Inc. (incorporated by reference to Exhibit 4.4 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 4.17 —Amended and Restated Shareholder Agreement dated August 11, 2003 between Dynegy Inc. and Chevron U.S.A. Inc. (incorporated by reference to Exhibit 4.5 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).

<u>Exhibit Number</u>	<u>Description</u>
4.18	—Indenture dated August 11, 2003 between Dynegy Inc. and Wilmington Trust Company, as trustee (incorporated by reference to Exhibit 4.6 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
4.19	—Junior Unsecured Subordinated Note due 2016 in the principal amount of \$225,000,000 issued on August 11, 2003 by Dynegy Inc. to Chevron U.S.A. Inc. (incorporated by reference to Exhibit 4.7 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
4.20	—Indenture dated as of August 11, 2003 among Dynegy Holdings Inc., the guarantors named therein, Wilmington Trust Company, as trustee, and Wells Fargo Bank Minnesota, N.A., as collateral trustee, including the form of promissory note for each series of notes issuable pursuant to the Indenture (incorporated by reference to Exhibit 4.8 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
4.21	—Indenture dated August 11, 2003 between Dynegy Inc., Dynegy Holdings Inc. and Wilmington Trust Company, as trustee, including the form of debenture issuable pursuant to the Indenture (incorporated by reference to Exhibit 4.9 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
4.22	—Registration Rights Agreement dated August 11, 2003 among Dynegy Inc., Dynegy Holdings Inc. and the initial purchasers named therein (incorporated by reference to Exhibit 4.10 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
4.23	—First Supplemental Indenture dated July 25, 2003 to that certain Indenture, dated as of September 26, 1996, between Dynegy Holdings Inc. and Wilmington Trust Company, as trustee (incorporated by reference to Exhibit 99.2 to the Current Report on Form 8-K of Dynegy Inc. filed on July 28, 2003, File No. 1-15659).
4.24	—Eighth Supplemental Indenture dated July 25, 2003 that certain Indenture, dated as of December 11, 1995, between Dynegy Holdings Inc. and Wilmington Trust Company, as trustee (incorporated by reference to Exhibit 99.3 to the Current Report on Form 8-K of Dynegy Inc. filed on July 28, 2003, File No. 1-15659).
	There have not been filed or incorporated as exhibits to this annual report, other debt instruments defining the rights of holders of our long-term debt, none of which relates to authorized indebtedness that exceeds 10% of our consolidated assets. We hereby agree to furnish a copy of any such instrument not previously filed to the SEC upon request.
10.1	—Dynegy Inc. Amended and Restated 1991 Stock Option Plan (incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1998 of Dynegy Inc., File No. 1-11156). ††
10.2	—Dynegy Inc. 1998 U.K. Stock Option Plan (incorporated by reference to Exhibit 10.4 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1998 of Dynegy Inc., File No. 1-11156). ††
10.3	—Dynegy Inc. Amended and Restated Employee Equity Option Plan (incorporated by reference to Exhibit 10.5 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1998 of Dynegy Inc., File No. 1-11156). ††
10.4	—Dynegy Inc. 1999 Long Term Incentive Plan (incorporated by reference to Exhibit 10.6 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1999 of Dynegy Inc., File No. 1-11156). ††

<u>Exhibit Number</u>	<u>Description</u>
10.5	—Dynergy Inc. 2000 Long Term Incentive Plan (incorporated by reference to Exhibit 10.7 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1999 of Dynergy Inc., File No. 1-11156). ††
10.6	—Dynergy Inc. 2001 Non-Executive Stock Incentive Plan (incorporated by reference to Exhibit 4.5 to the Registration Statement on Form S-8 of Dynergy Inc., Registration No. 333-76080). ††
10.7	—Dynergy Inc. 2002 Long Term Incentive Plan (incorporated by reference to Appendix A to the Definitive Proxy Statement on Schedule 14A of Dynergy Inc., File No. 1-15659, filed with the SEC on April 9, 2002). ††
10.8	—Extant, Inc. Equity Compensation Plan (incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-8 of Dynergy Inc., Registration No. 333-47422). ††
10.9	—Employment Agreement, effective October 23, 2002, between Bruce A. Williamson and Dynergy Inc. (incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2002 of Dynergy Inc., File No. 1-11156). ††
10.10	—Employment Agreement, effective February 1, 2000, between Charles L. Watson and Dynergy Inc. (incorporated by reference to Exhibit 10.9 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1999 of Dynergy Inc., File No. 1-11156)††
10.11	—Employment Agreement, effective February 1, 2000, between Stephen W. Bergstrom and Dynergy Inc. (incorporated by reference to Exhibit 10.10 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1999 of Dynergy Inc., File No. 1-11156). ††
10.12	—Employment Agreement, effective as of September 16, 2002, between R. Blake Young and Dynergy Inc. (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2002 of Dynergy Inc., File No. 1-15659). ††
10.13	—Employment Agreement, effective February 1, 2000, between Alec G. Dreyer and Dynergy Inc. (incorporated by reference to Exhibit 10.15 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2002 of Dynergy Inc., File No. 1-11156). ††
10.14	—Employment Agreement, effective December 2, 2002, between Nick J. Caruso and Dynergy Inc. (incorporated by reference to Exhibit 10.16 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2002 of Dynergy Inc., File No. 1-11156). ††
**10.15	—Employment Agreement, effective March 11, 2003, between Carol F. Graebner and Dynergy Inc. ††
10.16	—Dynergy Inc. Deferred Compensation Plan for Certain Directors (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended March 31, 2000 of Dynergy Inc., File No. 1-15659). ††
10.17	—Dynergy Inc. 401(k) Savings Plan, as amended and restated effective January 1, 2002 (incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-8 of Dynergy Inc., Registration No. 383-76570). ††
**10.18	—Amendment to the Dynergy Inc. 401(K) Savings Plan, effective January 1, 2004. ††
**10.19	—First Amendment to Dynergy Inc. 401(K) Savings Plan, effective February 11, 2002. ††
**10.20	—Second Amendment to Dynergy Inc. 401(K) Savings Plan, effective January 1, 2002. ††
**10.21	—Third Amendment to Dynergy Inc. 401(K) Savings Plan, effective October 1, 2003. ††
10.22	—Dynergy Inc. 401(k) Savings Plan Trust Agreement (incorporated by reference to Exhibit 10.2 to the Registration Statement on Form S-8 of Dynergy Inc., Registration No. 333-76570). ††
10.23	—Dynergy Inc. Deferred Compensation Plan (incorporated by reference to Exhibit 4.6 to the Registration Statement on Form S-8 of Dynergy Inc., Registration No. 333-76080). ††
10.24	—Dynergy Inc. Deferred Compensation Plan Trust Agreement (incorporated by reference to Exhibit 4.7 to the Registration Statement on Form S-8 of Dynergy Inc., Registration No. 333-76080). ††
10.25	—Dynergy Inc. Short-Term Executive Stock Purchase Loan Program (incorporated by reference to Exhibit 10.19 to the Annual Report on Form 10-K for the Year Ended December 31, 2001 of Dynergy Inc., File No. 1-15659). ††

<u>Exhibit Number</u>	<u>Description</u>
10.26	—Dynergy Inc. Deferred Compensation Plan for Certain Directors (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynergy Inc., File No. 1-15659). ††
10.27	—Dynergy Inc. Executive Severance Pay Plan, as amended effective September 30, 2003 (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 2003 of Dynergy Inc., File No. 1-15659). ††
**10.28	—Second Supplement to the Dynergy Inc. Executive Severance Pay Plan. ††
**10.29	—Dynergy Inc. Mid-Term Incentive Performance Award Program. ††
10.30	—Dynergy Northeast Generation, Inc. Savings Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-8 of Dynergy Inc., Registration No. 333-111985). ††
**10.31	—Amendment to the Dynergy Northeast Generation, Inc. Savings Incentive Plan, effective January 1, 2004. ††
10.32	—Dynergy Inc. Severance Pay Plan, as amended effective September 30, 2003 (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 2003 of Dynergy Inc., File No. 1-15659). ††
10.33	—Lease Agreement entered into on June 12, 1996 between Metropolitan Life Insurance Company and Metropolitan Tower Realty Company, Inc., as landlord, and NGC Corporation, as tenant (incorporated by reference to Exhibit 10.69 to the Registration Statement on Form S-4 of Midstream Combination Corp., Registration No. 333-09419).
10.34	—First Amendment to Lease Agreement entered into on June 12, 1996 between Metropolitan Life Insurance Company and Metropolitan Tower Realty Company, Inc., as landlord, and NGC Corporation, as tenant (incorporated by reference to Exhibit 10.70 to the Registration Statement on Form S-4 of Midstream Combination Corp., Registration No. 333-09419).
*10.35	—Master Natural Gas Liquids Purchase Agreement, dated as of September 1, 1996, between Warren Petroleum Company, Limited Partnership and Chevron U.S.A. Inc. (incorporated by reference to Exhibit 10.8 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 1996 of NGC Corporation, File No. 1-11156).
10.36	—Dynergy Inc. Severance Pay Plan (incorporated by reference to Exhibit 10.41 to the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1998 of Dynergy Inc., File No. 1-11156). ††
10.37	—Credit Agreement, dated as of April 1, 2003, among Dynergy Holdings Inc., as borrower, Dynergy Inc., as parent guarantor, various subsidiary guarantors and the lenders party thereto (incorporated by reference to Exhibit 10.31 to the Annual Report on Form 10-K for the Year Ended December 31, 2002 of Dynergy Inc., File No. 1-15659).
10.38	—Shared Security Agreement, dated April 1, 2003, among Dynergy Holdings, Inc., various grantors named therein, Wilmington Trust Company, as corporate trustee, and John M. Beeson, Jr., as individual trustee (incorporated by reference to Exhibit 10.32 to the Annual Report on Form 10-K for the Year Ended December 31, 2002 of Dynergy Inc., File No. 1-15659).
10.39	—Non-Shared Security Agreement, dated April 1, 2003, among Dynergy Inc., various grantors named therein and Bank One, N.A. as collateral agent (incorporated by reference to Exhibit 10.33 to the Annual Report on Form 10-K for the Year Ended December 31, 2002 of Dynergy Inc., File No. 1-15659).
10.40	—Collateral Trust and Intercreditor Agreement, dated as of April 1, 2003, among Dynergy Holdings Inc., various grantors named therein, Wilmington Trust Company, as corporate trustee, and John M. Beeson, Jr., as individual trustee (incorporated by reference to Exhibit 10.34 to the Annual Report on Form 10-K for the Year Ended December 31, 2002 of Dynergy Inc., File No. 1-15659).

**Exhibit
Number**

Description

- 10.41 —Third Amendment to the Loan Documents dated as of July 15, 2003 among Dynegy Holdings Inc., as borrower, Dynegy Inc., as parent guarantor, various subsidiary guarantors and the lenders party thereto, including the Lender Consent dated August 1, 2003 (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.42 —Fourth Amendment to the Credit Agreement dated as of October 9, 2003 among Dynegy Holdings Inc., as borrower, Dynegy Inc., as parent guarantor, various subsidiary guarantors and the lenders party thereto (incorporated by reference to Exhibit 99.3 to the Current Report on Form 8-K of Dynegy Inc. filed on October 15, 2003, File No. 1-15659).
- 10.43 —Series B Preferred Stock Exchange Agreement dated as of July 28, 2003 between Dynegy Inc. and Chevron U.S.A. Inc. (incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.44 —Indemnity Agreement dated August 11, 2003 among Dynegy Inc., Dynegy Holdings Inc. and Chevron U.S.A. Inc. (incorporated by reference to Exhibit 10.5 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.45 —Intercreditor Agreement dated August 11, 2003 among Dynegy Holdings Inc., various grantors named therein, Wilmington Trust Company, as corporate trustee, John M. Beeson, Jr., as individual trustee, Bank One, NA, as collateral agent, and Wells Fargo Bank Minnesota, N.A., as collateral trustee (incorporated by reference to Exhibit 10.6 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.46 —Second Lien Shared Security Agreement dated August 11, 2003 among Dynegy Holdings Inc., various grantors named therein and Wells Fargo Bank Minnesota, N.A., as collateral trustee (incorporated by reference to Exhibit 10.7 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.47 —Second Lien Non-Shared Security Agreement dated August 11, 2003 among Dynegy Inc., various grantors named therein and Wells Fargo Bank Minnesota, N.A., as collateral trustee (incorporated by reference to Exhibit 10.8 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.48 —Purchase Agreement dated August 1, 2003 among Dynegy Inc., Dynegy Holdings Inc. and the initial purchasers named therein (incorporated by reference to Exhibit 10.9 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.49 —Purchase Agreement dated August 1, 2003 among Dynegy Holdings Inc., the guarantors named therein and the initial purchasers named therein (incorporated by reference to Exhibit 10.10 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2003 of Dynegy Inc., File No. 1-15659).
- 10.50 —Purchase Agreement dated September 30, 2003 among Dynegy Holdings Inc., the guarantors named therein and the initial purchasers named therein (incorporated by reference to Exhibit 99.2 to the Current Report on Form 8-K of Dynegy Inc. filed on October 15, 2003, File No. 1-15659).
- 10.51 —Purchase Agreement dated February 2, 2004 among Dynegy Inc., Illinova Corporation, Illinova Generating Company and Ameren Corporation (incorporated by reference to Exhibit 2.1 to the Current Report on Form 8-K of Dynegy Inc. filed on February 4, 2004, File No. 1-15659).
- **14.1 —Dynegy Inc. Code of Ethics for Senior Financial Professionals.
- **21.1 —Subsidiaries of the Registrant.

<u>Exhibit Number</u>	<u>Description</u>
**23.1	—Consent of PricewaterhouseCoopers LLP.
**31.1	—Chief Executive Officer Certification Pursuant to Rule 13a-14(a) and 15d-14(a), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
**31.2	—Chief Financial Officer Certification Pursuant to Rule 13a-14(a) and 15d-14(a), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
†32.1	—Chief Executive Officer Certification Pursuant to 18 United States Code Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
†32.2	—Chief Financial Officer Certification Pursuant to 18 United States Code Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*	Exhibit omits certain information that we have filed separately with the SEC pursuant to a confidential treatment request pursuant to Rule 406 promulgated under the Securities Act of 1933, as amended.
**	Filed herewith
†	Pursuant to Securities and Exchange Commission Release No. 33-8238, this certification will be treated as “accompanying” this report and not “filed” as part of such report for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or the Exchange Act, or otherwise subject to the liability of Section 18 of the Exchange Act, and this certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act.

(b) Reports on Form 8-K of Dynegy Inc. for the fourth quarter of 2003.

1. During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K on October 2, 2003. Items 5 and 7 were reported and no financial statements were filed.

2. During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K on October 15, 2003. Items 5 and 7 were reported and no financial statements were filed.

3. During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K on October 30, 2003. Items 7 and 12 were reported and no financial statements were filed.

4. During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K on November 4, 2003. Items 5 and 7 were reported and no financial statements were filed.

5. During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K on November 18, 2003. Items 5 and 7 were reported and no financial statements were filed.

6. During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K on November 24, 2003. Items 5 and 7 were reported and no final statements were filed.

7. During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K on December 8, 2003. Items 5 and 7 were reported and no final statements were filed.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DYNEGY INC.

Date: February 27, 2004

By: /s/ BRUCE A. WILLIAMSON

Bruce A. Williamson
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

<u>/s/ BRUCE A. WILLIAMSON</u> Bruce A. Williamson	President, Chief Executive Officer and Director (Principal Executive Officer)	February 27, 2004
<u>/s/ NICK J. CARUSO</u> Nick J. Caruso	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 27, 2004
<u>/s/ HOLLI C. NICHOLS</u> Holli C. Nichols	Senior Vice President and Controller (Principal Accounting Officer)	February 27, 2004
<u>/s/ CHARLES E. BAYLESS</u> Charles E. Bayless	Director	February 27, 2004
<u>/s/ DAVID W. BIEGLER</u> David W. Biegler	Director	February 27, 2004
<u>/s/ LINDA W. BYNOE</u> Linda W. Bynoe	Director	February 27, 2004
<u>/s/ THOMAS D. CLARK, JR.</u> Thomas D. Clark, Jr.	Director	February 27, 2004
<u>/s/ DANIEL L. DIENSTBIER</u> Daniel L. Dienstbier	Director (Chairman of the Board)	February 27, 2004
<u>/s/ BARRY J. GALT</u> Barry J. Galt	Director	February 27, 2004
<u>/s/ PATRICIA A. HAMMICK</u> Patricia A. Hammick	Director	February 27, 2004
<u>/s/ ROBERT C. OELKERS</u> Robert C. Oelkers	Director	February 27, 2004
<u>/s/ JOE J. STEWART</u> Joe J. Stewart	Director	February 27, 2004
<u>/s/ WILLIAM L. TRUBECK</u> William L. Trubeck	Director	February 27, 2004
<u>/s/ JOHN S. WATSON</u> John S. Watson	Director	February 27, 2004
<u>/s/ RAYMOND I. WILCOX</u> Raymond I. Wilcox	Director	February 27, 2004

DYNEGY INC.

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders of Dynegy Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Dynegy Inc. and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 17, the Company is the subject of substantial litigation. The Company's ongoing liquidity, financial position and operating results may be adversely impacted by the nature, timing and amount of the resolution of such litigation. The consolidated financial statements do not include any adjustments, beyond existing accruals applicable under Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," that might result from the ultimate resolution of such matters.

As discussed in Note 2, the Company adopted the provisions of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," as of January 1, 2003. As discussed in Note 2, the Company adopted the provisions of Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," as of July 1, 2003. As discussed in Note 2, the Company adopted certain provisions of Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities – an interpretation of ARB 51 (revised December 2003)," as of December 31, 2003. As discussed in Note 2, the Company adopted the provisions of Statement of Financial Accounting Standards No. 132 (revised 2003), "Employers' Disclosures About Pensions and Other Postretirement Benefits – an Amendment of FASB Statements No. 87, 88, and 106 and a revision of FASB Statement No. 132," as of December 31, 2003. As discussed in Note 2, the Company adopted the provisions of Emerging Issues Task Force No. 02-03, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," related to the rescission of Emerging Issues Task Force Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," as of January 1, 2003. As discussed in Note 2, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," and Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," as of January 1, 2002.

PricewaterhouseCoopers LLP
Houston, Texas
February 26, 2004

DYNEGY INC.
CONSOLIDATED BALANCE SHEETS
(in millions, except share data)

	December 31, 2003	December 31, 2002
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 477	\$ 757
Restricted cash	19	17
Accounts receivable, net of allowance for doubtful accounts of \$184 and \$151, respectively	1,010	2,791
Accounts receivable, affiliates	25	31
Inventory	279	236
Assets from risk-management activities	818	2,618
Prepayments and other current assets	402	1,136
Total Current Assets	<u>3,030</u>	<u>7,586</u>
Property, Plant and Equipment	9,867	9,659
Accumulated depreciation	(1,471)	(1,201)
Property, Plant and Equipment, Net	8,396	8,458
Other Assets		
Unconsolidated investments	612	668
Assets from risk-management activities	629	2,529
Goodwill	154	396
Other long-term assets	472	462
Total Assets	<u>\$13,293</u>	<u>\$20,099</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 522	\$ 1,586
Accounts payable, affiliates	74	65
Accrued liabilities and other current liabilities	811	1,818
Liabilities from risk-management activities	838	2,418
Notes payable and current portion of long-term debt	245	861
Current portion of long-term debt to affiliates	86	—
Total Current Liabilities	<u>2,576</u>	<u>6,748</u>
Long-term debt	5,124	5,454
Long-term debt to affiliates	769	—
Total Long-term Debt	5,893	5,454
Other Liabilities		
Liabilities from risk-management activities	746	2,366
Deferred income taxes	751	951
Other long-term liabilities	750	924
Total Liabilities	<u>10,716</u>	<u>16,443</u>
Minority Interest	121	146
Commitments and Contingencies (Note 17)		
Redeemable Preferred Securities, redemption value of \$411 and \$1,711 at December 31, 2003 and December 31, 2002, respectively (Note 15)	411	1,423
Stockholders' Equity		
Class A Common Stock, no par value, 900,000,000 shares authorized at December 31, 2003 and December 31, 2002; 280,350,169 and 274,850,589 shares issued and outstanding at December 31, 2003 and December 31, 2002, respectively	2,848	2,825
Class B Common Stock, no par value, 360,000,000 shares authorized at December 31, 2003 and December 31, 2002; 96,891,014 shares issued and outstanding at December 31, 2003 and December 31, 2002	1,006	1,006
Additional paid-in capital	41	705
Subscriptions receivable	(8)	(12)
Accumulated other comprehensive loss, net of tax	(20)	(55)
Accumulated deficit	(1,754)	(2,314)
Treasury stock, at cost, 1,679,183 shares at December 31, 2003 and December 31, 2002	(68)	(68)
Total Stockholders' Equity	<u>2,045</u>	<u>2,087</u>
Total Liabilities and Stockholders' Equity	<u>\$13,293</u>	<u>\$20,099</u>

See the notes to the consolidated financial statements.

DYNEGY INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)

	Year Ended December 31,		
	2003	2002	2001
Revenues	\$ 5,787	\$ 5,326	\$ 9,124
Cost of sales, exclusive of depreciation shown separately below	(5,054)	(4,596)	(7,317)
Depreciation and amortization expense	(454)	(466)	(456)
Goodwill impairment	(242)	(897)	—
Impairment and other charges	(7)	(190)	—
Gain on sale of assets	29	7	36
General and administrative expenses	(366)	(325)	(420)
Operating income (loss)	(307)	(1,141)	967
Earnings (losses) from unconsolidated investments	124	(80)	191
Interest expense	(509)	(297)	(255)
Other income and expense, net	25	(59)	55
Minority interest income (expense)	3	(36)	(93)
Accumulated distributions associated with trust preferred securities	(8)	(12)	(22)
Income (loss) from continuing operations before income taxes	(672)	(1,625)	843
Income tax benefit (expense)	198	276	(357)
Income (loss) from continuing operations	(474)	(1,349)	486
Loss on discontinued operations, net of taxes (Note 3)	(19)	(1,154)	(82)
Income (loss) before cumulative effect of change in accounting principles	(493)	(2,503)	404
Cumulative effect of change in accounting principles, net of taxes (Note 2)	40	(234)	2
Net income (loss)	(453)	(2,737)	406
Less: preferred stock dividends (gain) (Note 15)	(1,013)	330	42
Net income (loss) applicable to common stockholders	<u>\$ 560</u>	<u>\$ (3,067)</u>	<u>\$ 364</u>
Earnings (Loss) Per Share (Note 16):			
Basic earnings (loss) per share:			
Earnings (loss) from continuing operations	\$ 1.44	\$ (4.59)	\$ 1.37
Loss from discontinued operations	(0.05)	(3.15)	(0.26)
Cumulative effect of change in accounting principles	0.11	(0.64)	0.01
Basic earnings (loss) per share	<u>\$ 1.50</u>	<u>\$ (8.38)</u>	<u>\$ 1.12</u>
Diluted earnings (loss) per share:			
Earnings (loss) from continuing operations	\$ 1.30	\$ (4.59)	\$ 1.31
Loss from discontinued operations	(0.04)	(3.15)	(0.25)
Cumulative effect of change in accounting principles	0.09	(0.64)	0.01
Diluted earnings (loss) per share	<u>\$ 1.35</u>	<u>\$ (8.38)</u>	<u>\$ 1.07</u>
Basic shares outstanding	374	366	326
Diluted shares outstanding	423	370	340

See the notes to the consolidated financial statements.

DYNEGY INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)

	Year Ended December 31,		
	2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ (453)	\$ (2,737)	\$ 406
Adjustments to reconcile net income (loss) to net cash flows from operating activities:			
Depreciation and amortization	525	613	486
Goodwill impairment	242	897	—
Impairment and other charges	7	847	—
(Earnings) losses from unconsolidated investments, net of cash distributions	33	232	(117)
Risk-management activities	382	638	(17)
Loss (gain) on sale of assets	(57)	620	(36)
Deferred income taxes	(210)	(630)	242
Cumulative effect of change in accounting principles (Note 2)	(40)	234	(2)
Reserve for doubtful accounts	19	68	55
Other	(9)	87	53
Changes in working capital:			
Accounts receivable	1,683	421	1,622
Inventory	93	3	24
Prepayments and other assets	726	(762)	(183)
Accounts payable and accrued liabilities	(2,017)	(454)	(2,011)
Changes in non-current assets and liabilities, net	(48)	(102)	28
Net cash provided by (used in) operating activities	876	(25)	550
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(333)	(947)	(2,551)
Investments in unconsolidated affiliates	(5)	(14)	(1,533)
Business acquisitions, net of cash acquired	—	(20)	(603)
Proceeds from asset sales, net	72	1,583	1,078
Other investing, net	—	75	(219)
Net cash provided by (used in) investing activities	(266)	677	(3,828)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from long-term borrowings	2,219	969	1,537
Net proceeds from short-term borrowings	—	181	—
Repayments of borrowings	(2,749)	(623)	(504)
Net cash flow from commercial paper and revolving lines of credit	(128)	(724)	599
Payment to ChevronTexaco for Series B preferred stock restructuring	(225)	—	—
Proceeds from issuance of capital stock	6	240	604
Proceeds from issuance of convertible preferred stock	—	—	1,500
Purchase of serial preferred securities of a subsidiary	—	(28)	—
Purchase of treasury stock	—	(1)	(68)
Redemption of Illinois Power Preferred Securities	—	—	(100)
Dividends and other distributions, net	—	(55)	(98)
Decrease (increase) in restricted cash	(2)	11	(1)
Other financing, net	(21)	(14)	(19)
Net cash provided by (used in) financing activities	(900)	(44)	3,450
Effect of exchange rate changes on cash	10	(59)	(23)
Net increase (decrease) in cash and cash equivalents	(280)	549	149
Cash and cash equivalents, beginning of period	757	208	59
Cash and cash equivalents, end of period	\$ 477	\$ 757	\$ 208

See the notes to the consolidated financial statements.

DYNEGY INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(in millions)

	Common Stock	Additional Paid-In Capital	Subscriptions Receivable	Accumulated Other Comprehensive Loss	Retained Earnings (Accumulated Deficit)	Treasury Stock	Total
December 31, 2000	\$2,912	\$ 15	\$—	\$ (15)	\$ 532	\$ (3)	\$ 3,441
Net income	—	—	—	—	406	—	406
Other comprehensive loss, net of tax	—	—	—	(12)	—	—	(12)
Common Stock issued	605	—	—	—	—	—	605
Subscriptions receivable	—	—	(38)	—	—	—	(38)
Implied dividend on Series B Preferred Stock	—	660	—	—	—	—	660
Options exercised	57	—	—	—	—	—	57
Dividends and other distributions	—	—	—	—	(140)	—	(140)
401(k) plan and profit sharing stock	13	—	—	—	—	—	13
Options granted	—	13	—	—	—	—	13
Treasury stock	—	—	—	—	—	(68)	(68)
December 31, 2001	\$3,587	\$ 688	\$ (38)	\$ (27)	\$ 798	\$ (71)	\$ 4,937
Net loss	—	—	—	—	(2,737)	—	(2,737)
Other comprehensive loss, net of tax	—	—	—	(28)	—	—	(28)
Differential of Series A Preferred Purchase	—	7	—	—	—	—	7
Common Stock issued	205	—	—	—	—	—	205
Subscriptions receivable	—	—	26	—	—	—	26
Options exercised	22	—	—	—	—	—	22
Dividends and other distributions	—	—	—	—	(375)	—	(375)
401(k) plan and profit sharing stock	17	—	—	—	—	—	17
Options granted	—	11	—	—	—	—	11
Treasury stock	—	(1)	—	—	—	3	2
December 31, 2002	\$3,831	\$ 705	\$ (12)	\$ (55)	\$ (2,314)	\$ (68)	\$ 2,087
Net loss	—	—	—	—	(453)	—	(453)
Other comprehensive income, net of tax	—	—	—	35	—	—	35
Series B Preferred Stock restructuring	—	(660)	—	—	1,224	—	564
Subscriptions receivable	—	—	4	—	—	—	4
Options exercised	15	(6)	—	—	—	—	9
Dividends and other distributions	—	—	—	—	(211)	—	(211)
401(k) plan and profit sharing stock	8	—	—	—	—	—	8
Options granted	—	2	—	—	—	—	2
December 31, 2003	\$3,854	\$ 41	\$ (8)	\$ (20)	\$ (1,754)	\$ (68)	\$ 2,045

See the notes to the consolidated financial statements.

DYNEGY INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in millions)

	Year Ended December 31,		
	2003	2002	2001
Net income (loss)	\$(453)	\$(2,737)	\$406
Cash flow hedging activities, net:			
Cumulative effect of transition adjustment	—	—	61
Unrealized mark-to-market gains arising during period, net	39	73	4
Reclassification of mark-to-market (gains) losses to earnings, net	(37)	(73)	(57)
Changes in cash flow hedging activities, net (net of tax expense of \$1, zero and \$5, respectively)	2	—	8
Foreign currency translation adjustments	24	31	(21)
Minimum pension liability (net of tax benefit (expense) of \$(5), \$38 and zero, respectively)	9	(66)	—
Unrealized gains on securities, net:			
Unrealized holding losses arising during period, net	—	—	(11)
Less: Reclassification adjustments for losses realized in net income (loss)	—	7	12
Net unrealized gains (net of tax expense of zero, \$3 and zero, respectively)	—	7	1
Other comprehensive income (loss), net of tax	35	(28)	(12)
Comprehensive income (loss)	<u>\$(418)</u>	<u>\$(2,765)</u>	<u>\$394</u>

See the notes to the consolidated financial statements.

DYNEGY INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Organization and Operations of the Company

Dynegy Inc. (together with our subsidiaries, "we", "us" or "our") is a holding company and conducts substantially all of our business through our subsidiaries. We own operating divisions engaged in power generation, natural gas liquids and regulated energy delivery. We also separately report the results of our customer risk management business. We had four reportable business segments in 2003: GEN, NGL, REG and CRM. We reported our results in these four business segments based on the diversity of their respective operations. Please see a description of abbreviations used in these footnotes beginning on page F-79.

Note 2—Accounting Policies

Our accounting policies conform to GAAP. Our most significant accounting policies are described below. The preparation of consolidated financial statements in conformity with GAAP requires management to develop estimates and to make assumptions that affect reported financial position and results of operation. These estimates and assumptions also impact the nature and extent of disclosure, if any, of contingent liabilities. We review significant estimates affecting our consolidated financial statements on a recurring basis and record the effect of any necessary adjustments prior to their publication. Judgments and estimates are based on our beliefs and assumptions derived from information available at the time such estimates are made. Adjustments made with respect to the use of these estimates often relate to information not previously available. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of financial statements. Estimates are primarily used in (1) developing fair value assumptions, including estimates of future cash flows and discounts rates, (2) analyzing tangible and intangible assets for possible impairment, (3) estimating the useful lives of our assets, (4) assessing future tax exposure and the realization of tax assets, (5) determining amounts to accrue for contingencies and (6) estimating various factors used to value our pension assets. Actual results could differ materially from any such estimates.

Principles of Consolidation. The accompanying consolidated financial statements include our accounts and the accounts of our majority-owned or controlled subsidiaries, and our proportionate share of assets, liabilities, revenues and expenses of undivided interests in certain gas processing facilities, after eliminating intercompany accounts and transactions. Certain reclassifications have been made to prior-period amounts to conform with current-period financial statement classifications.

Cash and Cash Equivalents. Cash and cash equivalents consist of all demand deposits and funds invested in short-term investments with original maturities of three months or less.

Restricted Cash. Restricted cash represents cash that is unavailable for general purpose cash needs. Restricted cash reflects amounts reserved for use in retiring Illinois Power's Transitional Funding Trust Notes. This is further discussed in Note 12—Debt—Illinois Power Transitional Funding Trust Notes beginning on page F-41.

Allowance for Doubtful Accounts. We establish provisions for losses on accounts receivable if it is reasonable to assume we will not collect all or part of outstanding balances. We review collectibility and establish or adjust our allowance as necessary primarily using a percent of balance methodology. The specific identification method is also used in certain circumstances.

Investment in Unconsolidated Affiliates. Investments in affiliates over which we may exercise significant influence, generally 20% to 50% ownership interests, are accounted for using the equity method. Any excess of our investment in affiliates, as compared to our share of the underlying equity, that is not recognized as goodwill is amortized over the estimated economic service lives of the underlying assets. Other investments over which

DYNEGY INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

we may not exercise significant influence and that have readily determinable fair values are considered available-for-sale and are recorded at quoted market values or at the lower of cost or net realizable value, if there are no readily determinable fair values. For securities with readily determinable fair values, the change in the unrealized gain or loss, net of deferred income tax, is recorded as a separate component of accumulated other comprehensive income (loss) in the consolidated statements of comprehensive income (loss). Realized gains and losses on investment transactions are determined using the specific identification method. All investments in unconsolidated affiliates are periodically assessed for other-than-temporary declines in value, with write-downs recognized in earnings (losses) from unconsolidated investments in the consolidated statements of operations.

Concentration of Credit Risk. We sell our energy products and services to customers in the electric and gas distribution industries and to entities engaged in industrial and petrochemical businesses. These industry concentrations have the potential to impact our overall exposure to credit risk, either positively or negatively, because the customer base may be similarly affected by changes in economic, industry, weather or other conditions.

Inventory. Our natural gas, natural gas liquids, coal and crude oil inventories are valued at the lower of weighted average cost or at market. Our materials and supplies inventory is carried at the lower of cost or market using the specific identification method.

Property, Plant and Equipment. Property, plant and equipment, which has consisted principally of gas gathering, processing, fractionation, terminalling and storage facilities, natural gas transportation and electric transmission lines, pipelines and power generating facilities, is recorded at historical cost. Expenditures for major replacements, renewals and major maintenance are capitalized. We consider major maintenance to be expenditures incurred on a cyclical basis to maintain and prolong the efficient operation of our assets. Expenditures for repairs and minor renewals to maintain assets in operating condition are expensed. Depreciation is provided using the straight-line method over the estimated economic service lives of the assets, ranging from three to 60 years. Composite depreciation rates ("composite rates") are applied to functional groups of assets having similar economic characteristics. The estimated economic service lives of our functional asset groups are as follows:

<u>Asset Group</u>	<u>Range of Years</u>
Power Generation Facilities	27 to 40
Natural Gas Gathering Systems and Processing Facilities	14 to 25
Fractionation, Terminalling and Natural Gas Liquids Storage Facilities	14 to 25
Transportation Equipment	5 to 10
Regulated Electric Assets	21 to 60
Regulated Gas Assets	27 to 50
Regulated Other Assets	14 to 46
Buildings and Improvements	10 to 40
Office and Miscellaneous Equipment	3 to 35

Gains and losses are not recognized for retirements of property, plant and equipment subject to composite rates until the asset group subject to the composite rate is retired. Gains and losses on sales of individual assets are reflected in gain on sale of assets in the consolidated statements of operations. Through December 31, 2001, we reviewed the carrying value of our long-lived assets in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of." In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses the accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121 and

DYNEGY INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

APB Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Under this standard, we evaluate an asset for impairment when events or circumstances indicate its carrying value may not be recovered. These events include market declines, changes in the manner in which we intend to use an asset or decisions to sell an asset and adverse changes in the legal or business environment. When we decide to exit or sell a long-lived asset or group of assets, we adjust the carrying value of these assets downward, if necessary, to the estimated sales price, less costs to sell. Our adoption of SFAS No. 144 on January 1, 2002 did not have any impact on our financial position or results of operations. See Note 4—Restructuring and Impairment Charges beginning on page F-22 for a discussion of impairment charges we recognized in 2002 and 2003.

Asset Retirement Obligations. In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." We adopted SFAS No. 143, which provides accounting requirements for costs associated with legal obligations to retire tangible, long-lived assets, effective January 1, 2003. Under SFAS No. 143, an ARO is recorded at fair value in the period in which it is incurred by increasing the carrying amount of the related long-lived asset. In each subsequent period, the liability is accreted towards the ultimate obligation amount and the capitalized ARO costs are depreciated over the useful life of the related asset.

As part of the transition adjustment in adopting SFAS No. 143, existing environmental liabilities in the amount of \$73 million were reversed in the first quarter 2003. The fair value of the remediation costs estimated to be incurred upon retirement of the respective assets is included in the ARO and was recorded upon adoption of SFAS No. 143. Since the previously accrued liabilities exceeded the fair value of the future retirement obligations, the impact of adopting SFAS No. 143 was an increase in earnings, net of tax, of \$34 million in the first quarter 2003, which is included in cumulative effect of change in accounting principles in the consolidated statements of operations. In addition to these liabilities, we also have potential retirement obligations for dismantlement of power generation facilities, power transmission assets, a fractionation facility and natural gas storage facilities. Our current intent is to maintain these facilities in a manner such that they will be operated indefinitely. As such, we cannot estimate any potential retirement obligations associated with these assets. Liabilities will be recorded in accordance with SFAS No. 143 at the time we are able to estimate any new AROs.

At January 1, 2003, our ARO liabilities were \$26 million for our GEN segment, \$9 million for our NGL segment and \$6 million for our REG segment. These retirement obligations relate to activities such as ash pond and landfill capping, closure and post-closure costs, environmental testing, remediation, monitoring and land and equipment lease obligations. Annual amortization of the assets resulting from adoption of this standard and the accretion of the liability towards the ultimate obligation amount was \$7 million in 2003. During 2003, accretion expense recognized for the fair value for all of our ARO liabilities totaled \$5 million. There were no additional AROs recorded or settled during 2003. During 2003, we changed the estimated timing of our estimated cash flows associated with our ARO liability in the REG segment due to delivery of notice of our intention to exercise our option to purchase the Tilton turbines, as further described at Note 12—Debt—Tilton Capital Lease beginning on page F-41, and reduced the liability by \$5 million, accordingly. At December 31, 2003, our ARO liabilities were \$30 million for our GEN segment, \$10 million for our NGL segment and \$1 million for our REG segment.